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SUBJECT: CENTRAL BANK CUTS RATES, BUT SOME BANKS KEEP DEPOSIT RATES STEADY

REF: A. CAIRO 476
[1](#)B. CAIRO 534
[1](#)C. CAIRO 1020
[1](#)D. CAIRO 282

[1](#)1. (U) Key Points

-- The Central Bank of Egypt (CBE) cut interest rates for the fourth time this year.

-- Several major Egyptian state and private banks responded by lowering their lending but not deposit rates.

-- The CBE will continue to monitor inflation and growth rates before another interest rate decision on July 30.

-- The CBE maintains a cautiously optimistic outlook on signs of economic recovery.

[1](#)2. (U) The Central Bank of Egypt (CBE) cut its overnight lending rate, deposit rate, and the discount rate by 50 basis points each at the June 18 meeting of its Monetary Policy Committee (MPC). Following this cut, the overnight deposit and lending rates stand at 9% and 10.5% respectively, with the discount rate at 9%. This is the fourth time that the CBE has cut interest rates in as many meetings this year, after having raised them last year to combat soaring inflation rates. The deposit rate is now the lowest it has been since March 2008. The monetary easing cycle began on February 12, when rates were cut by 100 bps (reftel A). That was followed by cuts of 50 bps after both its March 26 (reftel B) and May 14 (reftel C) meetings.

[1](#)3. (U) In a significant but not unprecedented development, several of Egypt's largest banks responded to the CBE decision by cutting their lending but not their deposit rates. In a poll of 24 top banks conducted by Egypt's leading financial daily, Al-Mal, seven banks, including the National Bank of Egypt and other state banks, kept their deposit rates firm, as 11 waited to make a decision. Only six banks followed the CBE's lead and lowered their deposit rates right away. Officials at banks that kept their deposit rates steady cited a desire to continue attracting depositors, particularly small deposits. At banks that described their status as "waiting," some officials explained that they wanted to monitor the market's reaction to the interest rate cuts before making a firm decision. Although banks are typically quicker to adjust deposit rates than lending rates in response to CBE decisions, recent low deposit growth likely influenced some banks either to remain firm or to wait to make a decision. Annual growth in local currency deposits has been dropping, reaching 7.4% in April 2009, down from its peak of 27.7% growth in March 2008.

[1](#)4. (U) In its statement, the MPC noted that headline CPI inflation is now at 10.2% year-on-year, a 17-month low. The MPC statement noted that CPI has declined 13.4 percentage points since peaking at 23% y-o-y in August 2008 and that domestic inflation on foodstuffs has fallen from 31% that same month to 12.5% in May 2009. The statement also cited slower domestic growth as a result of the

global financial crisis, which has dragged down GDP growth in Q3 2008/9 (Jan-Mar 2009) to 4.3% compared to 7.1% in Q3 2007/8. The CBE remains skeptical of signs of a quick recovery. It noted in its statement that although indications abound that the worst of the global downturn are over, it agreed with predictions that the global economy would recover slowly and gradually in 2010.

15. (U) The MPC's next regularly scheduled meeting will be July 30. Some analysts predict that the CBE is nearing the end of its easing cycle and is unlikely to cut rates a fifth time unless the Egyptian economy deteriorates further. However, many analysts did not foresee the most recent interest rate cut, citing positive monthly inflation rate changes, signs of possible domestic recovery and stable money supply growth. In its statement, the CBE indicated that it would continue to act to contain the effects of the global economic crisis, "provided that they do not conflict with the price stability objective," which remains the CBE's top priority (reftel D). A forthcoming World Bank report citing macroeconomic and price instability as top impediments to investment in Egypt is likely to reinforce these concerns. This summer, prices are likely to continue rising with still-robust demand, which the coming month of Ramadan, beginning August 21, will push up further. How quickly prices rise over the next month may provide an indication of the likelihood of further rate cuts at the end of July.

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